

USAID

OFFICE OF INSPECTOR GENERAL

Audit of the Management Discussion and Analysis Section of USAID's Fiscal Year 2000 Financial Statements

Audit Report Number 9-000-02-001-P

December 13, 2001



**U.S. Agency for International Development
Washington, D.C.**



U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

Office of Inspector General

December 13, 2001

MEMORANDUM

FOR: M/CFO, Michael T. Smokovich
DAA/PPC, Kenneth G. Schofield

FROM: IG/A/PA Director, Dianne L. Rawl /s/

SUBJECT: Audit of the Management Discussion and Analysis
Section of USAID's Fiscal Year 2000 Financial
Statements (*Audit Report Number 9-000-02-001-P*)

This memorandum is our report on the subject audit. In finalizing the report, we considered your comments to our draft report. Those comments are included, in their entirety, as Appendix II.

This report contains one recommendation to address weaknesses identified during this audit. We believe that this recommendation will improve USAID's internal controls over the performance measures contained in the Management Discussion and Analysis (MD&A) section of USAID's future financial statements. Based on the information provided by USAID's management officials, we do not consider the recommendation to have received a management decision. Please provide within 30 days any additional information related to actions planned or taken to implement the recommendation.

I want to express my sincere appreciation for the cooperation and courtesies extended to my staff during this audit.

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Summary of Results

Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements," dated October 16, 2000, requires auditors, at a minimum, to assess internal controls related to performance measures contained in the Management Discussion and Analysis (MD&A). The Office of Inspector General (OIG) also sought to determine whether USAID prepared its MD&A for fiscal year 2000 in compliance with applicable laws and regulations. (See pages 4-5.)

While the OIG found that the MD&A for fiscal year 2000 generally complied with applicable laws and regulations, we identified the following two areas which we believe should be brought to management's attention.

- The fiscal year 2000 MD&A did not meet all of the requirements of OMB Bulletin No. 97-01, "Form and Content of USAID's Financial Statements" dated October 16, 1996, as amended. (See pages 5-9.)
- Performance data presented in the MD&A may be inaccurate or incomplete because they were extracted from internal reports that, according to prior OIG audits,¹ had these problems. (See pages 9-10.)

To accomplish our objectives, we selected and reviewed a sample of Agency-level performance indicators that USAID officials had informed us would be reported in the MD&A. However, near the end of the period of time available for our review of these indicators, USAID officials informed us that they no longer intended to report agency-level indicators in the MD&A. Instead, they planned and reported on operating-unit-level indicators. (See page 12.)

Because of this change of plans, we were unable to perform a detailed review of the internal controls applicable to the new set of performance measures selected for the fiscal year 2000 MD&A. Although we were not able to verify the accuracy or completeness of the specific indicators selected in the MD&A, we had previously audited and reported on indicators similar to those on which the MD&A was based. Our audits had shown that performance data reported for these indicators may have been inaccurate or incomplete and that data quality limitations were not always disclosed. (See pages 9-10.)

¹ See Appendix III for a list of these audits.

In addition, we noted that the reports from which performance data were selected for the fiscal year 2000 MD&A generally reported performance achieved or recognized in fiscal year 1999 or earlier and, therefore, did not reflect the results of financial operations during fiscal year 2000. These deficiencies occurred because USAID's Office of the Chief Financial Officer, in collaboration with the Bureau for Policy and Program Coordination, did not have an adequate plan to ensure that the MD&A would meet OMB's requirements. We have recommended the development of a detailed plan. (See pages 8-9.)

Background

The Government Management Reform Act of 1994 requires that USAID annually submit audited financial statements to OMB and appropriate congressional committees. Pursuant to that Act, OMB issued Bulletin No. 97-01, which defines the form and content of USAID's financial statements, including the section entitled, Management Discussion and Analysis (MD&A). According to OMB Bulletin No. 97-01, the MD&A should at a minimum,

- describe an agency's mission, activities, program and financial results, and financial condition;
- provide meaningful and relevant information about the performance of an agency's programs; and
- disclose the extent to which programs are achieving their intended objectives.

USAID officials based the MD&A for fiscal year 2000 on the Agency's revised Strategic Plan issued January 24, 2001 and draft Performance Overview Report.²

Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements," dated October 16, 2000, which was effective for fiscal years ending on or after September 30, 2000, requires auditors to gain an understanding of the components of internal controls relating to the existence and completeness assertions relevant to the performance measures included in the MD&A and to report on those internal controls that have not been properly designed and placed in operation.

² The Performance Overview Report was designed to meet the requirements of the Government Performance and Results Act of 1993. At the time of our audit, only a draft of this document had been prepared. The final Performance Overview Report was issued on April 3, 2001.

Audit Objectives

The Office of Inspector General's (OIG) Performance Audits Division in Washington, D.C performed this audit. It was designed to assess USAID's:

- internal controls related to the performance measures contained in the MD&A; and
- compliance with applicable laws and regulations.

Appendix I contains a discussion of the scope and methodology for the audit.

Audit Findings

The Fiscal Year 2000 Management Discussion and Analysis Section Did Not Meet All Relevant Requirements

The section of USAID's fiscal year 2000 financial statements entitled Management Discussion and Analysis (MD&A) met some but not all of the requirements outlined in the Office of Management and Budget (OMB) Bulletin No. 97-01. This occurred primarily because USAID's Office of the Chief Financial Officer (CFO) did not have an adequate plan to prepare the MD&A and relied on performance information prepared by another USAID bureau. However, this information had not been designed to meet OMB requirements. As a result, the MD&A did not provide financial statement users with a fair presentation of USAID's program performance. The following paragraphs discuss these issues in detail.

The fiscal year 2000 MD&A was a 14-page report covering eight topics: What is USAID? What Does USAID Do? How Does USAID Work? Managing USAID for Results, USAID Program Results, Financial Highlights, Management Controls, and Audit Follow-up Program. In the following paragraphs, we describe the major requirements of OMB Bulletin No. 97-01 and our assessment as to whether they were met in the fiscal year 2000 MD&A.

Each performance goal should be clearly defined—In six brief paragraphs, the MD&A summarized USAID's six principal areas and the types of programs that were considered to be priorities in each

area.³ However, goals for these areas were not clearly defined. That is, the MD&A did not discuss the strategies and resources that USAID uses to achieve its performance goals. For example, goals were described in general terms such as “broad-based economic growth and agricultural development” and “strengthened democracy and good governance.”

The significance of performance trends should be described by providing important existing, currently known demands, risks, uncertainties, events, conditions and trends, both favorable and unfavorable, that affect the amounts reported in the financial statements. The discussion of these current factors should go beyond a mere description of the existing condition. The MD&A provided no information as to trends, risks, or uncertainties that might affect the financial statement. Although the document provided a statement of net cost of operations with subtotals for each of the six principle areas, there was no analysis of this information or linkage to fiscal year 2000 program accomplishments.

Explain what needed to be done to improve program performance, and compare program results to goals or benchmarks, by discussing the strategies and resources USAID used to achieve its performance goals. The MD&A discussed the fact that USAID had decided to measure the success of its programs by using self-assessments prepared by its many operating units as to whether they met, exceeded, or failed to meet targets set for 440 operating unit objectives. (The MD&A did not list these objectives or provide examples. However, it did report that 152 objectives supported economic growth and agricultural development goals, 107 supported democracy and governance goals, 23 supported education and training goals, 80 supported population and human health goals, 48 supported environmental goals, and 30 supported humanitarian assistance goals.) The MD&A simply stated that, overall, USAID met the targets set for objectives established under each of its six goal areas in fiscal year 1999. There was no assessment for fiscal year 2000.

Provide a clear picture of actual and planned performance and discuss both positive and negative results. Present explanatory information that would help readers understand the

³ The six program areas were economic growth and agricultural development; population, health and nutrition; the environment; democracy and governance; education and training; and humanitarian assistance. USAID also has one strategic goal related to USAID's management.

significance of the measures, and results, discuss any variations from goals and plans in relation to the strategic plan, and compare actual performance results to USAID's goals. The MD&A did not provide targets or actual accomplishments for any goal or supporting objective. The MD&A did not discuss any negative results. As stated above, the MD&A reported that, overall, objectives supporting all goals were met. The MD&A did, however, provide a one-page list of outputs related to USAID's one strategic goal related to management. Examples of these outputs include "a new program performance management workshop curriculum was developed and implemented," "85 New Entry Professionals joined USAID during FY 2000," "700 employees were trained in Acquisition and Assistance rules and procedures," and "Communication with partners was expanded." However, the MD&A did not compare these accomplishments to planned targets or provide an assessment as to whether the accomplishments were more or less than had been planned.

Explain the procedures that management has designed and followed to provide reasonable assurance that the reported performance information was reliable. The largest single section of the MD&A focused on issues related to USAID's decision to use operating unit-level objectives to assess USAID's performance. The MD&A noted the advantages and disadvantages of this decision and stated that a major drawback was the large number of different objectives that could not be aggregated to convey USAID's Agency-wide perspectives. The MD&A also provided an analysis of USAID's policy that required operating units to periodically assess their data collection procedures and the quality of the data collected. The MD&A did not report whether these policies were effective. However, recent audits have shown that, because operating units have not always complied with this guidance, their performance reports and performance assessments have not always been accurate, complete, or consistently collected.

We found that there were several reasons why the MD&A did not comply with OMB guidelines. One reason was the fact that, unlike the CFOs of many Federal agencies, USAID's CFO was not organizationally responsible for collecting data and reporting on the performance of USAID's programs. As a result, the CFO relied on the Bureau for Policy and Program Coordination (PPC) to provide performance data for the MD&A, as it had done in past years. As was the case in those years, the CFO's collaboration with PPC, with

respect to the preparation of performance data for the MD&A, was not entirely successful.

For example, in a prior OIG audit we determined that the collaboration between the CFO and PPC leading to the MD&A for fiscal year 1999 was unsuccessful. The resulting MD&A (1) did not meet OMB requirements, and (2) was not prepared in sufficient time for it to be reviewed by our office. To help prevent a recurrence of this situation, we recommended that the CFO reach an agreement with PPC on the details of a comprehensive plan to prepare the MD&A in an acceptable and prompt manner.⁴

In response, the CFO and PPC agreed on a plan for preparing the fiscal year 2000 MD&A. In addition to assigning specific responsibilities to each office, the plan established a schedule for the completion of major steps and documents. For example, the CFO agreed to base the MD&A for fiscal year 2000 on a draft version of a document that PPC planned to prepare to meet the requirements of the Government Performance and Results Act.⁵

However, the plan did not require that the draft document contain all the elements needed to meet OMB's requirements for the preparation of the MD&A and, in fact, it did not. The CFO did not obtain the missing information from another source. As a result, the MD&A did not comply with OMB Bulletin 97-01, and it did not provide financial statement users with a fair presentation of program performance, particularly as it related to \$6.73 billion reported as the net cost of operations.⁶ We are, therefore, making the following recommendation.

Recommendation No. 1: We recommend that USAID's Office of the Chief Financial Officer, in collaboration with the Bureau for Policy and Program Coordination, develop and implement a detailed plan to prepare the Management Discussion and Analysis in accordance with the reporting requirements included in current Office of Management and Budget guidance. In addition to establishing milestones, and assigning responsibilities, the plan

⁴ Report No. 0-000-00-006-F, "Report on USAID's Consolidated Financial Statements, Internal Controls, and Compliance for Fiscal Year 1999," February 18, 2000, discussed this finding.

⁵ The final version of this document, USAID's Performance Overview Report for Fiscal Year 2000, was issued on April 3, 2001.

⁶ The net cost of operations, according to the fiscal year 2000 Statement of Net Cost, was \$6.73 billion. However, this amount has not been audited.

should include steps to ensure that the Management Discussion and Analysis:

- **explains the significance of performance trends,**
- **compares program results to goals or benchmarks,**
- **includes both positive and negative results, and**
- **presents explanatory information that would help readers understand the significance of the measures, results achieved, and variations from goals and plans.**

This plan should be updated regularly, as needed, to reflect any changes that could prevent the MD&A from meeting OMB's requirements. Because the CFO previously decided to rely on PPC for data needed to comment on the performance of USAID's programs, these offices must collaborate to the extent necessary to ensure that OMB requirements are met.

Assessments of Program Results in the MD&A May Have Been Based on Inaccurate or Incomplete Data

The discussion of program performance contained in the fiscal year 2000 MD&A was based on data contained in a draft of the USAID's Performance Overview Report. That report was, in turn, based on annual performance reports prepared and submitted by USAID operating units to their respective bureaus. As a result, the discussion of performance in the MD&A was subject to the same data quality weaknesses present in the operating unit reports. Our audits of these reports have noted several data quality weaknesses that we have attributed to the fact that operating units do not always comply with USAID's guidance for performance monitoring systems. As a result, the discussion and assessment of program performance in the fiscal year 2000 MD&A may have been based on incomplete or inaccurate data. The following paragraphs discuss this issue more fully.

The CFO decided to base the discussion of program performance contained in the fiscal year 2000 MD&A on a draft version of USAID's Performance Overview Report for fiscal year 2000. The performance data contained in the draft and final Performance Overview Report, both prepared by PPC, were based largely on data submitted in 1999 by USAID's operating units in their Results Review and Resource Request (R4) Reports. In these reports, operating units established targets and compared actual performance to planned

performance. In addition, although USAID's financial statements for fiscal year 2000 focused on USAID's financial position as of September 30, 2000, the MD&A summarized program performance results achieved in fiscal year 1999 or earlier. The MD&A did, however, report outputs related to management goals that were accomplished in fiscal year 2000. The sources of these data were not reported, but such data were not subject to the same rigorous guidance for measurement and verification as were performance data.

Because of the CFO's late decision to use operating unit-level performance data in the fiscal year 2000 MD&A, we did not have time to review the credibility of data reported in the MD&A before it was issued in March 2001. However, we have recently completed audits of the quality of data in seven R4 reports selected from among over 100 R4 reports that constituted the total pool of reports on which the MD&A was based. (See Appendix III for a list of these audit reports.) We have no reason to believe that the seven audited R4 reports were different in any material respect from the many unaudited R4 reports in the pool. Our audits showed that the seven operating units did not always report accurate or complete data, prepare adequate performance monitoring plans, perform adequate data quality assessments, and disclose known data quality limitations in their R4 reports. We have issued a separate report⁷ to USAID's management covering operating unit compliance with USAID's guidance for the preparation of performance monitoring plans and data quality assessments. Therefore, we did not make a recommendation related to these issues in this report.

Management Comments and Our Evaluation

In response to our draft report, management officials from both the Office of the Chief Financial Officer (CFO) and the Bureau for Policy and Program Coordination (PPC) indicated that they generally agreed with the sole recommendation in the report. With regard to that recommendation, management indicated that PPC, in collaboration with other bureaus and offices, including the CFO, was revising and updating the Agency's Annual Performance Plan (APP), which included a methodology for establishing better performance measures than were available under previous plans. Management also stated that, while the fiscal year 2001 MD&A would be based on the draft Annual Performance Report (APR) already submitted to the OIG, the fiscal year 2002 MD&A would be produced using data collected in

⁷Report No. 9-000-01-005-P, "Audit of Performance Monitoring for Indicators Appearing In Selected USAID Operating Units' Results Review and Resource Request Reports," dated September 27, 2001, discussed this finding.

new mission annual reports (previously known as “R4” reports). However, management did not explain how these changes would address certain problems noted in our report. For example, management did not clearly state that either the APP or the new mission annual reports would assign responsibility (to the Office of the CFO or to PPC) for drafting the MD&A in a manner that would both meet OMB form and content requirements and be completed in sufficient time to be reviewed by our office. Nor did management clearly state whether these changes would allow USAID to report timely data in its MD&A. Therefore, we do not consider the recommendation to have received a management decision and request that the Office of the CFO and PPC, within 30 days, provide additional information, relating more specifically to our recommendation.

With regard to our second finding, management stated that it disagreed with our statement that program performance information reported in the fiscal year 2000 MD&A may have been based on inaccurate or incomplete data. Management requested that we re-write this finding to explain measures the Agency has taken to improve performance data quality. We believe that our assessment of the fiscal year 2000 MD&A accurately reflects the situation at the time of the audit, which, as noted in our report, covered performance data for fiscal year 1999. Although USAID management has recently issued improved guidance and conducted training to help operating units collect and report performance data that meet specific quality standards, those changes did not take place early enough to affect performance results reported in the fiscal year 2000 MD&A. Further, recent audit work continues to show inconsistent compliance with Agency guidance. Therefore, we have not modified this section of our report.

Scope and Methodology

Scope

We conducted this audit in accordance with generally accepted government auditing standards. The purpose of our work was not to form an opinion on the information reported in the Management Discussion and Analysis (MD&A). Instead, it was to assess USAID's:

- internal controls related to the performance measures contained in the MD&A; and
- compliance with applicable laws and regulations.

We limited our work to assessing USAID/Washington's internal controls relating to the MD&A, but did not attempt to form an opinion on the system of internal controls taken as a whole. Instead we were to report on those significant control policies and procedures that had not been properly designed or placed in operation and those that we found to be ineffective.

We commenced our fieldwork by gaining an understanding of the design of the significant internal controls relating to the existence and completeness assertions as required by the Office of Management and Budget Bulletin No. 01-02. Our scope was impaired because we selected and reviewed a sample of agency-level performance indicators, which USAID officials informed us would be reported in the MD&A. After our fieldwork was almost complete, USAID officials informed us that the performance information previously identified would not be reported in the MD&A, but instead operating-unit-level indicators would be reported. That discussion occurred too late for us to complete our work. However, because the performance information presented in the MD&A was based on performance information previously audited by the OIG, we were able to comment on the internal controls over the performance information reported in the MD&A as referenced in those reports.

The fieldwork was conducted in Washington, D.C., from July 20, 2000, through February 26, 2001.

Methodology

We attempted to assess USAID's:

- internal controls related to the performance measures contained in the fiscal year 2000 MD&A, and
- compliance with applicable laws and regulations.

Our review was primarily based on the information presented in the performance goals and results section of the MD&A. We also performed a limited review of the "Mission and Organizational Structure" section of the MD&A. We selected a judgmental sample of six performance indicators identified in the MD&A—one from each program goal area. Generally, we did not assess the quality of the performance indicators themselves. We did not attempt to verify the accuracy of data in the MD&A and performed only limited tests on the data itself to assess the controls established by USAID.

We reviewed the November 14, 2000, draft version of USAID's MD&A; USAID's draft Performance Overview Report for fiscal year 2000; and seven OIG audit reports of operating units' R4 reports. In addition, we interviewed responsible USAID officials and USAID contractors.

Management Comments



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NOV 20 2001

To: Dianne Rawl, Director, IG/A/PA

From: Ken Schofield, PPC/DAA
Michael T. Smokovich, FM/CFO

Subject: FY 2000 Management Discussion and Analysis Audit

PPC and FM have reviewed the subject audit and its sole recommendation, which is that:

We recommend that the Chief Financial Officer in collaboration with the Bureau for Policy and Program Coordination prepare a detailed plan to prepare USAID's management discussion and analysis in accordance with the Office of Management and Budget Bulletin No. 97-01. That plan should establish milestones, assign responsibilities, and establish a methodology for selecting performance measures which must be related to the Agency's strategic plan—which credibly measures the results of Agency programs, including both positive and negative results. In addition, the plan should require the management discussion and analysis to:

- Explain the significance of trends,
- Compare program results to goals or benchmarks,
- Show variations from goals and plans, and
- Explain what needs to be done to improve program performance.

This plan should be updated annually as needed.

1. In general, PPC and the CFO agree with the recommendation. PPC, in collaboration with other bureaus and offices, including the CFO, is currently concluding its revision and updating of the Annual Performance Plan (APP), which establishes milestones, assigns responsibilities, and establishes a methodology for selecting performance measures. As in the past, the MD&A will be produced using the data collected in mission annual reports (previously known as the 'R4'). We note, however, the following:

- One of the objectives of the current APR/APP is to establish better performance measures than were available under the previous plans. It may take time to develop the new trends and goals and benchmarks.
- The 2001 MD&A will be based on the draft APR submitted to IG; the 2002 MD&A will incorporate changes resulting from this audit within the replacement R4 process, the resulting APR, and flow into the MD&A.

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2. PPC disagrees with the statement that “Program Performance Information in USAID’s MD&A May Have Been Based on Inaccurate or Incomplete Data.” The standard for determining “inaccurate or incomplete” appears to be that USAID’s performance management system be 100% reliable in all aspects. This section of the report uses versions of the phrase “operating units did not always report accurate or complete data.” This is the same language that has been used by the OIG for the past four years, and does not reflect the fact, documented in several OIG briefings, that USAID’s performance information is steadily improving. The use of the word “always” also sets a standard that USAID can never meet, nor should attempt to meet. It would be too expensive to attempt to reach 100% reliability, nor is it necessary to have 100% reliability to manage properly.

Over the past year, the OIG has recognized that USAID has made marked improvements in its performance management systems, including the recognition in the summary of the last round of performance audits that the OIG’s recommendations on how to improve these systems were closed even before they were issued.

Therefore, we request that the section entitled “Program Performance Information In USAID’s MD&A May Have Been Based on Inaccurate or Incomplete Information” be re-titled to “Performance Information in ... is Improving” and that this section be re-written to explain measures that have been taken, and documented to improve data quality.

Appendix III

Prior OIG Audits of R4 Reports

Below is a list of the seven OIG audit reports referenced in this report.

Report No. 1-512-00-005-P, "Audit of USAID/Brazil's Performance Monitoring for Indicators," July 17, 2000.

Report No. 9-000-00-003-P, "Audit of Global Bureau's Center for Economic Growth and Agricultural Development's Performance Monitoring for Indicators Appearing in the Fiscal Year 2002 Results Review and Resource Request Report," September 26, 2000.

Report Number 4-612-01-001-P, "Audit of USAID/Malawi's Performance Monitoring for Indicators Appearing in the Fiscal Year 2002 Results Review and Resource Request Report," October 19, 2000.

Report No. B-186-01-003-P, "Audit of USAID/Romania's Performance Monitoring for Indicators," February 26, 2001.

Report No. 5-367-01-002-P, "Audit of USAID/Nepal's Performance Monitoring for Indicators Appearing in the Fiscal Year 2002 Results Review and Resource Request Report," March 9, 2001.

Report No. 6-263-01-003-P, "Audit of USAID/Egypt's Performance Monitoring for Indicators Appearing in the FY 2002 Results Review and Resources Request Report," March 20, 2001.

Report No. 7-641-00-007-P, "Audit of USAID/Ghana's Performance Monitoring for Indicators Appearing in the FY 2001 Results Review and Resource Request," June 30, 2000.